S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
Wisconsin Electric Power Company d/b/a	)	Case No. U-16424
We Energies for approval of a Power Supply	)	
Cost Recovery Plan and authorization of	)	
monthly Power Supply Cost Recovery	)	
Factors for the year 2010	)	

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on August 25, 2011.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before September 15, 2011, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before September 29, 2011. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Dennis Mack

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Dennis W. Mack
Administrative Law Judge

August 25, 2011
Lansing, Michigan

STATE OF MICHIGAN

MICHIGAN ADMINISTRATIVE HEARING SYSTEM

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **Wisconsin Electric Power Company** d/b/a We Energies for approval of a Power Supply Cost Recovery Plan and authorization of monthly Power Supply Cost Recovery Factors for the year 2010	Case No. U-16424

PROPOSAL FOR DECISION

I.

PROCEDURAL HISTORY

On September 30, 2010, Wisconsin Electric Power Company, d/b/a We Energies (Company), filed an Application with the Michigan Public Service Commission (Commission). The Application seeks authorization to implement the Company's 2011 Power Supply Cost Recovery (PSCR) plan and five-year forecast, and for authority to implement PSCR factors for the calendar year 2011, under the authority of 1982 PA 304 (Act 304). During a duly noticed pre-hearing on November 18, 2010, counsel for the Company and Commission Staff appeared. 1 TR 4-5. In addition, petitions to intervene filed by Tilden Mining Company and Empire Mining Partnership (Mines), and the Citizens against Rate Excess (CARE) were granted. [1]

[1] The pre-hearing conference was conducted by Administrative Law Judge Barbara Stump, and upon her retirement the case was transferred to the undersigned.

The evidentiary hearing was conducted on May 5, 2011. During the hearing the Company entered the direct and rebuttal testimony of its employees Thomas P. Lorden, Senior Project Specialist in the Regulatory Affairs and Policy Department, and Jeff Knitter, Manager-Special Projects in the Wholesale Energy and Fuels Department. In addition, the Company entered 20 exhibits entered as Exhibits A-1 through A-20. CARE offered the testimony of Dr. Robert Loube, Ph.D., a Vice President and principal owner of Rolka Loube Saltzer Associates, a consulting firm. CARE offered nine (9) exhibits entered as CAR-1 through CAR-9. The Mines offered the testimony of Michael P. Gorman, Managing Principal of Brubaker & Associates, Inc., and James W. Collins, Jr., a senior consultant for Brubaker & Associates, Inc. The Mines offered 79 exhibits that were entered as MIN-1 through MIN-79. The parties waived cross-examination of the witnesses, and stipulated to the binding in of all pre-filed testimony, the admission of all pre-filed exhibits, and the admission of identified discovery responses. 2 TR 20, 244.[2] Consistent with the schedule agreed to during the pre-hearing conference, the parties filed briefs and reply briefs.

II.

STATUTORY REQUIREMENTS

Act 304 provides for PSCR clauses that "permits the monthly adjustment of rates for power supply to allow the utility to recover the booked costs, including transportation costs, reclamation costs, and disposal and reprocessing costs, of fuel burned by the utility for electric generation and the booked costs of purchased and net interchanged

[2] Under a Protective Order entered on January 4, 2010, portions of the testimony and certain exhibits deemed confidential were filed and are maintained separately from redacted/public versions of the evidence.

power transactions by the utility, incurred under reasonable and prudent policies and practices." MCL 460.6j(1)(a). In 1984, the Company's PSCR clause was approved by the Commission in Case No. U-7635.

To implement its PSCR clause, the Company must annually file a "plan describing the expected sources of electric power supply and changes in the cost of power supply anticipated over a future 12-month period specified by the commission and requesting for each of those 12 months a specific power supply cost recovery factor." MCL 460.6j(3). In addition, the PSCR plan must:

> [D]escribe all major contracts and power supply arrangements entered into by the utility for providing power supply during the specified 12-month period. The description of the major contracts and arrangements shall include the price of fuel, the duration of the contract or arrangement, and an explanation or description of any other term or provision as required by the commission. The plan shall also include the utility's evaluation of the reasonableness and prudence of its decisions to provide power supply in the manner described in the plan, in light of its existing sources of electrical generation, and an explanation of the actions taken by the utility to minimize the cost of fuel to the utility.
> MCL 460.6(j)(3).

Finally, contemporaneous with the PSCR plan, the Company must file with the Commission:

> [A] 5-year forecast of the power supply requirements of its customers, its anticipated sources of supply, and projections of power supply costs, in light of its existing sources of electrical generation and sources of electrical generation under construction. The forecast shall include a description of all relevant major contracts and power supply arrangements entered into or contemplated by the utility, and such other information as the commission may require.
> MCL 460.6j(4).

Upon the filing of the PSCR plan and 5-year forecast, the Commission must:

> [C]onduct a proceeding, to be known as a power supply and cost review, for the purpose of evaluating the reasonableness and prudence of the power supply cost recovery plan filed by a utility pursuant to subsection (3), and establishing the power supply cost recovery factors to implement

a power supply cost recovery clause incorporated in the electric rates or rate schedule of the utility.
MCL 460.6j(5).

Accordingly, this case requires a determination of the reasonableness and prudence of both the decisions underlying the proposed plan, along with the proposed plan itself. MCL 460.6j(5)(6).

III.

THE POSITIONS OF THE PARTIES

A. The Company's PSCR Plan

In its Application the Company seeks approval of maximum authorized PSCR factors of $0.00538/kWh for 2011. The factors were based on: the cost base of power supply included in base rates of $40.54 MWh at the customer level set in a July 1, 2010 Order (July 1 Order) issued by the Commission in Case No. U-15981; a 2011 PSCR factor of $0.00305/kWh; and a 2009-2010 PSCR reconciliation surcharge of $0.00233/kWh. Subsequently, the Company revised its request based on: an increase in its PSCR base from $0.04216 to $0.04225 per kWh under an Order on Rehearing the Commission entered on October 14, 2010, in Case No. U-15981; 2011 power supply adjustments; and renewable energy purchases directly assigned to the Company's Wisconsin RPS. See Exhibit A-17 (TPL-12). Combining the revised 2011 PSCR factor with the 2009-2010 reconciliation, the Company seeks a 2011 PSCR factor of $0.00465/kWh.

Mr. Lorden testified to the data underlying the Company's PSCR factors proposed for 2011. 2 TR 24. To develop the average of the power supply costs, Mr. Lorden used projected base power supply costs from power the Company will generate and purchase in 2011, along with the costs approved by a Commission in the Company's last rate case (Case No. U-15981).[3] 2 TR 25. In general, the costs are developed by forecasting the demand of the Company's customers for electricity, projecting the generating system and/or power purchased to meet that demand, and the delivered cost of fuel required to generate the electricity. 2 TR 25-26.

As for specifics, the demand forecast for 2011, which was formulated using historic sales and weather data through May of 2010, and economic and demographic activity through June of 2010, is contained in Exhibit A-2. The projection of the demand for the 5 year plan period (2011 to 2015) is contained in Exhibit A-1, and reflects the expected loss of industrial and municipal customers during that period. 2 TR 33-34. There is no evidence that the expected loss of these customers is unreasonable. Mr. Lorden testified the adequacy of the Company's generating units in relation to projected demand go into the second component of the average power supply cost. 2 TR 34. In this regard, the Company considers its generating unit operating characteristics, including a determination of the reasonable level of system reliability, along with fuel costs, planned outages, firm transmission availability, and projected energy costs from Midwest Independent System Operator (MISO). The projections of the energy generated by the Company, the fuel type utilized to generate that output, along with the expected sales and purchases necessary to meet the demand forecast for the plan period are contained in Exhibits A-3 through A-6.

Mr. Lorden also testified about the renewable energy aspects of the Company's PSCR plan. The Company submitted a renewable energy plan that was approved by

[3] *In the matter of the application of Wisconsin Electric Power Company for authority to increase its rates for the generation and distribution of electricity and for other relief*, Opinion and Order, Case No. U-15981, dated July 1, 2010.

the Commission in an Order entered on March 2, 2010, Case No. U-15812.[4] Subsequently, the Commission denied the Company's request to recover renewable energy costs not covered by that plan in its last rate case, holding they were properly addressed in a PSCR proceeding. Opinion and Order, Case No. U-15981, July 1, 2010, pp 39-40. Those costs were the investment in, and O&M costs related to, the Company's hydro and wind generating stations. 2 TR 41. Exhibit A-7 depicts the renewable energy that the Company is acquiring to meet the requirements of Act 295, subject to the statutory cap on surcharges, and that only the incremental cost of the transfer price is recoverable through the renewable energy surcharge. 2 TR 43. The transfer price portion is to be recovered through the PSCR mechanism and the incremental costs are to be recovered through the renewable energy surcharge. 2 TR 43. Mr. Lorden testified that it would be unreasonable to include wind and hydro generation in the PSCR costs calculations while denying the Company any recovery of the costs to generate that power. 2 TR 44. He testified that the hydro systems were over fifty years old, and prior to renewable energy requirements, had been included in both base rates and PSCR factors. 2 TR 45.

Mr. Knitter testified to the Company's power supply costs for 2011. 2 TR 93. Those costs include power purchase and sales contracts, which include those in the Company's 2010 PSCR plan and two new ones entered into in 2011. The 2011 contracts are for 5 years, and provide 150,000 MWh/yr for Renewable Energy Credits (RECs), and 150,000 MWh/yr for a combination of RECs and energy. 2 TR 93; Exhibit A-13 (JEK-2). The Company has a long-term power purchase agreement (PPA) with

[4] Public Act 295 of 2008, known as the "Clean, Renewable, and Efficient Energy Act," requires all providers of electric service in this state establish, *inter alia*, renewable energy programs by filing renewable energy plans with the Commission.

Zion Energy that was approved by the Commission in Case No. U-13266. [5] Mr. Knitter testified to the factors that have caused a change to Company's power supply plan between 2010 and 2011: both of its Elm Road Generating units will begin operation in 2011; the Company expects the sale of its share in Edgewater 5 will be consummated in 2011; and upgraded capacity at both Point Beach Unit 1 and 2 on-line in 2011. 2 TR 96-97. Mr. Knitter noted the Point Beach Unit 1 and 2 energy coming on line in 2011 is forecasted to be above market price. However, he testified it is reasonable to assume the Company will keep the capacity and energy from the units because it will not add CO2 emissions to its portfolio, which in the long run will lead to a reduction in customer's rates. 2 TR 97.

With the changes in its resource supply plan, and based on projected peak demand in 2011, the Company expects to have 706 MW of capacity above its Minimum Reserve Requirement. Exhibit A-12. The excess capacity was attributed to decreased customer usage because of the current state of the economy, reduction of the Company's Minimum Reserve Requirements, and renewable energy requirements. 2 TR 95. Concomitantly, Mr. Knitter testified the Company expects negligible new capacity sales in 2011, but projects $13,800,000 in revenue from the sale of capacity under short-term and long-term markets to participants in MISO and PJM, and utilities outside of these markets. 2 TR 98; Exhibits A-13 and A-14. This revenue will off-set the Company's power supply costs. In this regard, Mr. Knitter testified the Company plans no changes from its 2010 coal procurement methods and procedures, or any shortages of coal in 2011. 2 TR 103, 106. The Company has a series of contracts to

5 The Commission directed an examination of the Zion Energy PPA in the "company's 2011 PSCR plan case." See Case No. U-15981, July 1, 2010 Order, p 32. That examination is made under the analysis of the claims raised by the Mines, infra.

purchase coal in 2011, along with rail transportation agreements to deliver the coal to its generation facilities. 2 TR 103-104; Exhibit A-15. Mr. Knitter testified to the following cost increases between 2010 and 2011: $10,000,000 for the cost of coal; $33,000,000 for the transportation costs of coal under a new contract that was reached through competitive bidding; $8,000,000 for transportation fuel surcharges; and $7,000,000 for coal inventory. 2 TR 104-106.

B. CARE's Challenges to the Plan

Robert Loube, Ph.D., a Vice President and principal of Rolka Loube Saltzer Associates, a consulting firm specializing in utility regulation, testified on behalf of CARE. Exhibit CARE-1. Dr. Loube undertook a review and analysis of the Company's 2011 PSCR factors for the purpose of determining whether they are just and reasonable. 2 TR 132. In so doing, Dr. Loube took issue with the Company's calculations of its 2010 PSCR reconciliation and its proposed 2011 factors. As for the 2010 PSCR reconciliation, Dr. Loube substituted estimated sales, cost, and revenue for the last 4 months of the year with the actual results. Using actual data, Dr. Loube testified the under recovery of negative $5,327,654 increased to negative $6,188,892, which he testified requires, standing alone, an adjustment of the 2011 PSCR factors. 2 TR 135.

Dr. Loube also updated the Company's 2010 PSCR alternative energy costs by replacing the Company's $0.0692 per KWH cost of renewable energy, with the MISO cost of $0.0199 per KWH. 2 TR 136; Exhibit CARE-4. Dr. Loube contends the Company purchased the higher-cost renewable energy to satisfy regulatory requirements in another state, and improperly seeks to transfer those costs to its customers in Michigan. 2 TR 134. Dr. Loube used the difference between the cost of the Company's actual purchases in 2010 and the cost of energy on MISO, which equates to $0.0493 per KWH, and recalculated the 2010 true-up factor at $0.00237. 2 TR 136; Exhibit CARE-5. As for the 2011 PSCR factor, Dr. Loube eliminated renewable energy costs he deemed unreasonable and imprudent under a multi-step process. 2 TR 137. In so doing, Dr. Loube determined the annual factor should be 2.81, which he combined with the revised 2010 PSCR true-up factor to devise a 2011 PSCR factor of 5.18, which he recommends the Commission utilize to establish a $0.00518 per KHW 2011 PSCR. 2 TR 138.

C. The Mines' Challenges to the Plan

On behalf of the Mines, Mr. Gorman testified to three general propositions. First, Mr. Gorman opined the Company's PSCR plan factor of $3.05 per MWh is "significantly overstated." 2 TR 145. Mr. Gorman also commented on the 2009 reconciliation true-up factor of $0.20 per MWh and 2010 reconciliation factor of $2.13 per MWh, which were added to the PSCR factor to formulate the Company's proposed total 2011 PSCR factor of 5.38/MWh. 2 TR 145-146. Finally, Mr. Gorman testified concerning what he termed the excess revenues generated from "the inflated PSCR factor of $5.29/MWh…" the Company self-implemented on January 1, 2011. 2 TR 146. Mr. Gorman opined the Company's 2011 PSCR plan factor should be no higher than $1.82 per MWh and that the prior year reconciliation surcharge should be $1.03 per MWh for a total factor of $2.85 per MWh. 2 TR 146. In addition, the Company's excess capacity above its reserve requirement requires a limitation on its cost recovery. 2 TR 155. Mr. Gorman testified to certain aspects of the Company's operations that he claims requires incremental reductions in the 2011 PSCR factor. One is the Zion Energy PPA, which he claims was not used to satisfy the Company's capacity requirements. Rather, the PPA constitutes 47% of the Company's 2011 excess capacity, and eliminating it would reduce the 2011 plan factor by $0.61 per MWh. 2 TR 156. Additional capacity is also received from the Point Beach nuclear plant, and since no need for that energy has been established, Mr. Gorman recommends it be removed from the 2011 PSCR plan. 2 TR 157-160. Mr. Gorman also asserts the projected RSG make-whole payments in the PSCR plan and the actual amounts differ because the projected numbers do not include amounts for the Presque Isle plant. 2 TR 164. Therefore, the 2011 PSCR plan should include the make-whole payments for Presque Isle, with a corresponding reduction of the PSCR plan factor by $0.28 per MWh. 2 TR 165-166.

Mr. Gorman testified the Company can comply with Wisconsin renewable energy requirements through existing and proposed wind, hydro and biomass plants, along with purchased renewable power. 2 TR 167. Similar to Dr. Loube, Mr. Gorman contends the Company has included renewable energy costs under Wisconsin requirements in its PSCR plan, thereby shifting the costs to its Michigan customers. 2 TR 168. Mr. Gorman termed this purported shift as improper because it does not provide power supply benefit to Michigan customers, nor does it constitute fuel costs, purchased power, or net interchanged power, none of which are allowable in a PSCR plan. 2 TR 169-170. Eliminating what Mr. Gorman characterized as Wisconsin required renewable power costs would reduce the PSCR factor by $0.27 per MWh. 2 TR 171-172.

The Company had a projected cost of zero for its wind and hydro facilities in its PSCR cases until the Commission removed the costs of these facilities from base rates in Case No. U-15981. The Company now seeks a replacement power cost adjustment to recoup these expenses. 2 TR 173. Mr. Gorman testified the Company's calculation of this replacement power cost is unreasonable because utilizing the MISO market price conflicts with a least-cost planning approach. 2 TR 176. He recommended that this cost be set at the level of $1,378,000 that was in the Company's last rate case, and remain unchanged in the future. In so doing, the 2011 PSCR factor would be reduced by $0.42 per MWh. 2 TR 176-177. Along the same lines, Mr. Gorman notes the Act 295 renewable energy plan transfer price of $50.05 per MWh was established in Case No. U-15812. 2 TR 177-178. Mr. Gorman opined an updated transfer price of $33.44 per MWh is more reasonable because it is consistent with current locational energy markets, and applying that updated price reduces the 2011 PSCR factor by $0.08 per MWh. 2 TR 179.

Mr. Gorman also testified regarding the Company's Elm Road Generating Station (ERGS). In its 2010 PSCR plan, the Company projected an entire year of operation from the facility's Unit 1, and 4 months of operation from Unit 2. Due to construction delays, Unit 1 operated for 11 months with frequent outages in 2010, and Unit 2 did not operate at all, meaning the Company used less coal then projected for 2010. 2 TR 180. Also as a result of the delays, the Company received $6,000,000 in liquidated damages from Bechtel. Mr. Gorman recommended the damages be fully incorporated in the 2011 PSCR plan, reducing the factor by $0.20 per MWh. 2 TR 182. Mr. Gorman testified that while the Company had a large amount of unplanned outages at its generating plants due to overhauls taking longer than expected, coupled with unexpected mechanical difficulties, once resolved, he expected the outages to resemble historical averages. 2 TR 192. Having said that, he takes issue with the outage level projected for ERGS Units 1 and 2, terming them as unusually high, and recommended that a lower amount of a 2% Equivalent Forced Outage Rate (EFOR). 2 TR 193-194.

Mr. Gorman also took issue with the Company designating one of its coal-fired generating facilities as a "must run" (always running irrespective of demand), as opposed to “economic” (on only when required) generator. 2 TR 183-184. A "must run" facility is necessary to preserve system reliability and security, but Mr. Gorman asserts the Company has not provided any information demonstrating why the Company’s coal-fired plants require that method of operation. 2 TR 184. In the alternative, Mr. Gorman recommended that the Company dispatch non-steam heating load facilities on an "economic" basis, which would reduce the PSCR factor by $0.30 per MWh. 2 TR 185.

Mr. Gorman commented on the spent nuclear fuel issue, testifying that the Company had received $45,500,000 from the Department of Energy (DOE) in settlement of its nonperformance under a contract to store and dispose of spent nuclear fuel. 2 TR 197. He testified that the net settlement amount of $31,000,000 should be returned to customers as quickly as possible through the PSCR factor, resulting in a credit of $1.02 per MWh. 2 TR 198-199.

Mr. Gorman testified that the Company included a 2009 PSCR reconciliation true-up of $0.20 per MWh in the 2011 PSCR plan factor. He recommended disallowing the true-up factor because the elimination of unreasonable and imprudent costs incurred by the Company negates the need for the true-up factor. 2 TR 200-201. Mr. Gorman also testified that he did not support the 2010 PSCR under-recovery amount and it should be zero, or in the alternative half of the requested $2,667,000. 2 TR 202-203. Finally, Mr. Gorman opined the Company has been collecting an inflated PSCR factor of $5.29 per MWH for 2011, and recommended that the 2011 PSCR plan factor should be $2.85 per MWh. 2 TR 204-205.

Mr. Collins' opined that certain of the Company's 2011 PSCR plan costs are unreasonable they are significantly overstated and outdated. 2 TR 230. For example, Mr. Collins testified the Company utilized the 2011 NYMEX forward curve on September 3, 2010, in setting its gas price delivered forecast at $4.736/MMBtu. 2 TR 232. However, market trend reflects a decrease in natural gas prices as evident by the fact the price dropped by $0.613/MMBtu by March 4, 2011, which equates to 13% from September 3, 2010. Mr. Collins testified that the forecast should be changed to $4.136/MMBtu, which is the price forecast for 2011. 2 TR 232-233. Overall, this updated forecast reduces the Company's 2011 total fuel costs by $22,903,000, reducing the plan factor by $0.78/MWh. 2 TR 235. With respect to fuel oil, Mr. Collins testified that the Company's fuel oil hedge transaction fees and option premium costs of $2,542,000 were not a reasonable estimate and should be reduced. 2 TR 236-237. Further testimony regarding fuel oil and coal reductions recommended by Mr. Collins were redacted due to a confidentiality agreement. 2 TR 236-241.

IV.

ANALYSIS OF THE ISSUES

As set forth above, CARE and the Mines raise a number of issues that they contend require reductions in the factors proposed by the Company. In response, the

Company indicated it would; remove any amount for the Point Beach Power Plant uprates in its 2011 PSCR factors; adjust the proposed Presque Isle Revenue Sufficiency Guarantee Make-Whole Payment; accept the proposed Edgewater 5 adjustment; accept an adjustment to the cost of fuel oil hedges included in coal costs; remove the cost of renewable energy credits directly assigned to Wisconsin; and reduce the PSCR factor to reflect the Commission's October 14, 2010 Order on Rehearing in Case No. U-15981 holding on lease pre-payment deferrals for ERGS Unit 2. Exhibit A-17. Accordingly, the Company reduced the 2011 PSCR factor it proposed in its application to $4.65/MWh (or $0.00465/kWh). See Reply Brief – Attachment A. In light of these actions, a review of the remaining issues will be undertaken.

CARE contends the Company's 2011 Annual PSCR factor should be reduced from 3.05 to 2.81, and the 2011 PSCR factor reduced from $0.00538 per kWh to $0.00518 per kWh. 2 TR 136-138. The stated basis for these adjustments is twofold. First, Dr. Loube testified this adjustment is warranted because the Company's renewable energy costs are not reasonable and prudent, which affects its 2010 PSCR reconciliation and its 2011 PSCR plan factor. Second, the Company is forcing its Michigan customers to subsidize renewable energy costs imposed in other jurisdictions. The validity of these contentions is addressed below.

The Mines' seek a reduction of the Company's PSCR factor based on the following 12 grounds:

1. <u>A $0.78/MWh Reduction to Account for Current 2011 Natural Gas Price Levels.</u>

The Company utilized the September 3, 2010, NYMEX natural gas futures price forecast to project its 2011 gas costs. Given that the Company filed its PSCR plan on

September 30, 2011, utilizing that forecast is entirely reasonable. As can be expected, due to market fluctuations the projected price of natural gas on March 4, 2011, was 13% less than the price projected in the September 2010. To the Mines, utilizing the March 4, 2011, NYMEX natural gas futures price forecast is warranted, along with the corresponding reduction in the factor. The Company counters this argument by noting the March 28, 2011 NYMEX natural gas futures price for April-December 2011 was 10% higher than the March 4 forecast the Mines rely on. TR 108-109. If that projection holds, the Company's gas costs will be reduced by $5,100,000 for 2011. 2 TR 111. To the Company, the difference in projected costs between March 4 and March 28, 2011, is indicative of the price volatility in the natural gas market, and more importantly goes to the reasonableness of its initial projection. Further, as Mr. Knitter testified, the lowering of natural gas prices is not a zero-sum proposition because it will "reduce the generator revenue the Company receives from the MISO for the sale of Company generation. For the 2011 PSCR plan year, the Company is in a net sales position in the MISO market so the lower cost of purchases is more than offset by the reduction in generator revenue. In addition, lower LMPs will affect the amount of make-whole payments the Company will receive from MISO." 2 TR 110. Finally, the proper means to address the Company's actual costs for natural gas and its September of 2010 projection is in its 2011 PSCR reconciliation case. Based on this record, I find the Company's projected natural gas cost for 2011 is reasonable. I also find the natural gas cost proposed by the Mines is unreasonable.

2. <u>The 2011 PSCR Plan Factor Should be Reduced to Properly Reflect Actual Incurred Transaction Fees and Option Premium Levels Through the End of December 2010 for the Company's Fuel Oil Hedge Program, and Account for the Financial Value of the Already Executed 2011 Fuel Oil Program Hedges.</u>

The Company utilizes a fuel hedging program to mitigate the impact of increases in coal transportations costs. For 2011, the Company projects the program will cost $2.542 million. 2 TR 235. Consistent with Mr. Collins' testimony, the Mines assert that cost is defective for two reasons. First, most fuel hedging transactions, and thus their costs, were completed during 2010, making it unreasonable to include them in the 2011 PSCR. Second, while the Company included the financial value of its 2011 natural gas hedge transactions in its projected costs, it failed to include the mark-to-market value. [6] Based on these contentions, the Mines argue the 2011 PSCR plan factor must be adjusted.

In regards to the first contention, as Mr. Knitter testified, the Company has not completed its 2011 fuel hedging program, and volatility in those markets has already resulted in an increase in the Company's projected program costs. 2 TR 114-115. As for the mark-to-market value of a fuel hedge transaction, it is unknown whether the value will be a gain or a loss based, again, on market volatility. In fact, under more recent 2011 fuel oil futures prices, the Company estimates the cost of the program will increase by $1.87 million. 2 TR 113. As was the case with the Company's natural gas cost projection, that projected increase, along with the $687,000 reduction in the Company's value of hedged volume for coal inventory, should be addressed in the 2011 PSCR reconciliation case. Based on this record, I find the projected cost of the Company's 2011 fuel hedging program is not unreasonable.

[6] This value, which can be calculated throughout the life of contract, is based on the contract strike price and the actual prevailing market price when the contract expires.

3. <u>The PSCR Plan Factor Should be Reduced by $0.61/MWh to Reflect the Exclusion of All Capacity and Energy Costs Associated with the Zion Energy PPA.</u>

In the Company's last rate case the Commission directed "Staff and other interested parties to address the reasonableness and prudence of the Zion PPA in…the company's 2011 PSCR plan case." July 1, 2010 Order, Case No. U-15981, p 32. [7] The Mines contend that in light of the Company's excess generating capacity, which it estimates will average 888/MW annually between 2011 and 2015, the Zion PPA should be excluded from the 2011 PSCR. 2 TR 155. Mr. Gorman attributed a significant portion of this capacity to ERGS Unit 1 & 2, and notes the Zion PPA capacity has been bid into the PJM market even before those facilities have come on-line. 2 TR 156. Mr. Gorman also relies on Staff's assertion in Case No. U-15981 that the Zion PPA was the least useful of the Company's power supply assets.

There are a number of problems with Mr. Gorman's opinion. First, as noted by Staff, the ERGS Unit 2 is not included in the Company's Michigan rates under the Commission's holding in Case No. U-15981. Accordingly, using that facility as a basis to reduce the 2011 PSCR factor, or attributing it to the Company's current excess capacity in Michigan, is inappropriate. Second, and more importantly, Mr. Gorman's analysis of the Zion PPA is premised on current conditions, not the conditions that existed when the agreement was entered into in 2002. This is contrary to the principle "that the Legislature intended that the determination whether the actions of a utility were reasonable and prudent should be made in light of existing conditions at the time the decision [under review] was made." *Attorney General v Public Service Commission*,

[7] The Zion Energy PPA, which dates from 2002, was approved by the Commission in 2003 (Case No. U-13266) and has been included in every one of the Company's PSCR plan and reconciliation cases that time. 2 TR 94.

161 Mich App 506, 517 (1987). In this regard, Mr. Knitter testified the Zion PPA was intended to coincide with the commencement of operation of ERGS, and under the PPA's terms the capacity was reduced in 2008, and will be reduced again in 2013. 2 TR 95. Mr. Knitter also testified the Company's current excess capacity is directly attributable to current economic conditions, which were certainly unforeseeable in 2002. In addition, putting the Zion PPA capacity on the PJM market is also a benefit to the Company's customers because the sales offset PSCR costs.

Based on the foregoing, the record supports the position of the Company and Staff, and I find the costs associated with the Zion PPA in 2011 are reasonable and prudent.

4. <u>The 2011 PSCR Plan Factor Should be Reduced by $0.42/MWh to Reflect the Level of the Company's calculated Michigan PSCR Related Cost Impact Associated with the Removal of Wisconsin Renewable Portfolio Standards for Wind and Hydro Generation from Michigan Base Rates as Established in Case No. U-15981.</u>

To comply with a 2006 enactment from the state of Wisconsin, 2.27% of the Company's sales in that state since 2009 consisted of renewable energy. Mr. Gorman testified that energy, which came from purchased power transactions and renewable energy sources, is included in the Company's 2011 PSCR plan as "Renewable Energy – Other." 2 TR 167. Given that the Company has proposed renewable energy costs for Michigan under another line item, titled "Act 295 – Renewable Energy Plan," Mr. Gorman asserts the Company's customers in Michigan are improperly subsidizing its purchases for customers in Wisconsin. Mr. Gorman also testified that in previous PSCR plan and reconciliation proceedings the Company did not ascribe fuel costs for energy generated by wind and hydro. 2 TR 173. However, because the Commission disallowed costs for the Company's wind and hydro operations in the last rate case, the 2011 PSCR plan includes a power cost adjustment specific to Michigan for wind and hydro energy. The Company proposes using MISO energy market prices as a proxy for this replacement power. Mr. Gorman considers this imprudent because the MISO energy costs are higher than that obtained in a power purchase agreement, or under the Company's hedging program. 2 TR 176. In addition, Mr. Gorman testified this adjustment, which he termed was for a "fictional energy void" because the Company's wind and hydro facilities will operate during 2011, could be made up from existing generation source. 2 TR 149.

Dr. Loube's opinion is premised on a comparison of the contract prices to the current average rate for purchases of energy through MISO. 2 TR 133-135. However, the Company notes the MISO costs were unknown at the time it entered into the contracts. Thus those costs are irrelevant in determining the reasonableness and prudence of prior contracting decisions. In support, the Company relies on the principle that only the circumstances that existed contemporaneous with the entering of the agreement are relevant in determining whether it was reasonable and prudent. Since the Company's argument is consistent with the holding in *Detroit Edison v PSC*, 261 Mich App 448 (2004), Dr. Loube's contention is rejected.

The Company challenges a number of facts underlying Mr. Gorman's opinion. First, the Company notes the renewable energy allocated to Michigan is separate and distinct from that allocated to Wisconsin. In this regard, Mr. Lorden testified the line item for "Renewable Energy – Other" refers to mandated purchases from the Company's customers under Customer-owned generation tariffs, which is independent of its obligations under Wisconsin's RPS requirements. 2 TR 64-65; Exhibit A-7. The line item reflects total system costs, a portion of which is allocated to Michigan customers on an energy basis. Under a long-standing PSCR cost allocation methodology, the Company only charges the customers in a specific jurisdiction the cost of the energy delivered to that jurisdiction. 2 TR 65. Therefore, contrary to Mr. Gorman's assertion, the Company's Michigan customers are not subsidizing renewable energy obligations in other states. In addition, the Company no longer carries the costs associated with its wind and hydro facilities in its base rates, meaning they must be recovered through a PSCR plan. The plan uses the MISO energy price as a proxy. Mr. Lorden testified the adjustment represents the hourly generation of energy from wind and hydro sources and is priced at the MISO locational marginal price for the same time-period. 2 TR 75.

Based on the foregoing, the contention that Michigan ratepayers are subsidizing the Company's operations in Wisconsin is inaccurate. Rather, I find the Company has taken steps to keep the energy costs separate and distinct. As for the wind and hydro replacement power adjustment, the MISO energy market price is less than that from the Company's power supply and represents the real-time price of energy, and is thus a reasonable proxy. Accordingly, the argument of CARE and the Mines on both points are factually and legally deficient, and thus are rejected.

5. <u>The 2011 PSCR Plan Factor Should be Reduced by $0.08/MWh to Feflect an Updated Michigan Renewable Energy Plan Transfer Price Consistent with Public Act 295.</u>

Mr. Gorman relies on a provision in Act 295 that directs the Commission to annually establish the transfer price per megawatt hour to support his contention that the 2011 PSCR plan price of $50.05 per MWh is excessive. MCL 460.1047(2)(b)(iv); 2 TR 178-179. Mr. Gorman testified the transfer price in the PSCR plan, which is at least 2 years old, should be set at the average MISO power purchase price of $33.44 per MWh. 2 TR 179. Both Staff and the Company cite to Commission Orders that hold the provision relied on by Mr. Gorman does not apply to a PSCR plan or reconciliation case. [8] Based on that authority, Mr. Gorman's contention that the transfer price should be adjusted in a proceeding on a 2011 PSCR plan is rejected. Further, I find the 2011 PSCR plan transfer price of $50.05 per MWh is reasonable and prudent.

6. <u>The 2011 PSCR Plan Factor Should be Reduced by $0.20/MWh to Reflect the Inclusion of $6 million in Liquidated Damages from Bechtel for Delays Associated with the ERGS Commercial Operation Date.</u>

The liquidated damages were a result of Bechtel not meeting the Scheduled Commercial Operation Date for the ERGS facility. 2 TR 118. The Mines' theory is that the Company had to purchase replacement power due to the delay in ERGS going on-line, and thus the damages should be reflected in the 2011 PSCR. However, Mr. Knitter testified the delay resulted in extra months of construction costs and/or pre-lease payments, which are not PSCR costs. 2 TR 118. Those added costs attributable to the Company's Michigan customers were accrued in a deferred regulatory asset account and will be amortized over the life of the facility lease. The ratemaking of those costs will be addressed in a future rate proceeding. 2 TR 119. Staff agrees that the disposition of the liquidated damages is properly addressed in the general rate case, as

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[8] *In the matter, on the Commission's own motion, to implement 2008 PA 295 through issuance of a temporary order as required by MCL 460.1191*, Case No. U-15800, Opinion and Order dated December 4, 2008, p 25; *In the matter of the application of Consumers Energy Company for reconciliation of power supply cost recovery costs and revenues for the calendar year 2009*, Case No. U-15675-R, Opinion and Order dated June 16, 2011, p 25; *In the matter of the application of Wisconsin Electric Power Company for approval of a renewable energy plan, an energy optimization plan, a renewable energy surcharge, and an energy optimization surcharge to comply with the requirements of Public Act 95 of 2008,* Case No. U-15812, Order dated May 26, 2009, p 2.

opposed to a PSCR plan case. Accordingly, I find liquated damages received under the Bechtel contract are not a proper consideration in a PSCR plan case.

7. The 2011 PSCR Plan Factor Should be Reduced by $0.30/MWh to Reflect the Utilization of an "Economic" Dispatch Approach for its Non-Steam Heating Coal Fired Facilities in the Development of the Company's PROMOD Model Used to Project 2011 PSCR Costs.

A generation unit can be committed to run by MISO on either a "must run," i.e. the facility generates electricity irrespective of market conditions, or "economic," i.e. meaning the facility only runs when it is economical under market conditions. The Mines acknowledges that MISO requires a "must run" generator where it is necessary to maintain the transmission's systems reliability and security. However, the Mines contend that the "must run" dispatch for the Company's fuel powered generating facilities is unnecessary. Thus, the Company should dispatch these facilities on an "economic" model, and the $744,968 in fuel costs associated with the "must run" designation should be deducted from the 2011 PSCR plan. 2 TR 185.

The Company took issue with this assertion through Mr. Knitter's testimony, which notes that considerations beyond fuel costs must be factored in an "economic" model. Specifically, the repeated cycling of the system increases the chance of equipment failure, which leads to increased costs for repair, maintenance, warranties and long-term service agreements. 2 TR 120. In addition, outages entail costs, such as the need for special handling of SO2 scrubber absorber contents. Start ups of coal fueled facilities, which take a long time before reaching full load, increase emission rates. The time required for start up can also put the transmission system at risk because electricity is not available when needed. Along the same lines, a failed start increases the risk of the load being exposed to higher prices. None of these costs or risks is factored in the PROMOD model of unit start-up.[9] 2 TR 121. While the costs of start-up are not included in a PSCR plan, they are ultimately borne by the Company's customers through increased base rates, which Staff contends inveigh against granting the reduction sought by the Mines. Based on Mr. Knitter's testimony, the Company's designation of a "must run" coal fired facility and commitment of its generation into the MISO market, are reasonable and prudent. Further, Mr. Gorman's testimony that fuel costs are the only consideration in designating said facilities cannot be accepted.

8. <u>The 2011 PSCR Plan Factor Should be Reduced to Reflect Reasonable 2011 Equivalent Forced Outage Rate Levels in the Company's PROMOD Model Used to Project 2011 PSCR Costs.</u>

In general, the Mines contend the Company's 2011 PSCR plan includes an inflated EFOR, which, in turn, leads to inflated plan costs. Mr. Gorman offers a number of theories to support this contention. 2 TR 196. First, he notes the Company anticipates significantly more outages than what it reported to the North American Electric Reliability Corporation's Generator Availability Data System (NERC GADS) as the annual forced outage rates for all of its generation units between 2004-2008. Mr. Gorman takes issue with the hourly outages anticipated in the 2011 plan because it is based, in part, on the average EFOR between 2005-2009, and in 2009 the Company's actual generation was 9.2% less than the planned generation. 2 TR 190, Table 3. Mr. Gorman attributed this increase to unusually high level of unplanned outages, stemming from delays in overhaul projects and mechanical issues, at Oak Creek Units 5, 6 & 7 in 2009. 2 TR 190-192. Mr. Gorman opined the atypical generation performance in 2009

[9] The PROMOD is the Company's "security constrained economic dispatch model which simulates the MISO Energy Market." 2 TR 105-106.

skews the Company's EFOR level, and utilizing that level does not provide a reliable indication of outages in 2011. In that alternative, Mr. Gorman asserts utilizing the average outage levels for 2004-2008 will provide a better indication of the Company's actual generator performance in 2011. 2 TR 193. Mr. Gorman also notes the Company removed reserve shutdown hours from the total service hours component of the EFOR.[10] 2 TR 185. Mr. Gorman opined a reserve shutdown is not indicative of the generating unit's reliability because it is available, and thus should be calculated is ascertaining the unit's total service hours.

In response, the Company notes that its planned outages in 2011, are based on the nature and scope of projects it intends to undertake, which provides more accurate information than historical data. 2 TR 123. For example, the five-year average planned outage for the Company's Oak Creek Unit 8 is four weeks, but the work at the facility will only require two weeks of outage in 2011. By focusing on planned outages in this manner, the Company's forecast, which proposes a $247,000 adjustment for planned outages in 2011, is more accurate than merely relying on data from 2004 to 2008. For this reason, Mr. Gorman's contention that the planned outages in the 2011 PSCR plan are deficient cannot be sustained. In regards to forced outages, which by their nature cannot be predicted with the same degree of certainty as planned outages, the Company has always relied on the most recent five-year average. 2 TR 124. In addition, the Company considers other factors, such as coal plants experiencing higher failure rates at the beginning and end of their service, which levels out based on a lower rate between those periods. 2 TR 125. To reject the accepted methodology utilized by

[10] Mr. Gorman testified reserve shutdown, also termed an economy outage, occurs whenever a generating unit is unavailable and not synchronized based on a lack of demand.

the Company in formulating its EFOR is unreasonable. Accordingly, the most recent five-year average of forced outages is the most reliable manner to forecast the same for a particular year.

9. <u>The Michigan Allocated Portion of the $31 Million Net Proceeds Associated with the Recent Spent Nuclear Fuel Settlement is PSCR Related Revenue and Should be Included in its 2011 PSCR Costs Calculation. Under the Company's Forecasted 2011 Total System and Michigan-Specific Retail Sales Levels Results, this Requires a 2011 PSCR Credit of $(1.02)/MWh.</u>

The settlement is a result of the failure of the U.S. Department of Energy (DOE) to take possession and dispose of spent nuclear fuel from the Point Beach Power Plant under a contract with the Company. As a result of the breach, the Company had to construct and maintain dry cask storage facilities for the spent fuel at Point Beach. 2 TR 77. As noted by Staff, the handling and storage of spent nuclear fuel, along with the spent nuclear fuel fees remitted by the Company to the DOE, are properly considered a PSCR cost. Conversely, capital expenditures for constructing a spent nuclear fuel storage facility are not a PSCR cost, but rather are properly recoverable in a general rate case. Mr. Lorden testified the Company intends to address the settlement in a future ratemaking proceeding. 2 TR 79. The settlement that Mr. Gorman testified should be included in this case does not constitute a refund of the SNF fees remitted to the DOE by the Company. Rather, as Mr. Lorden testified, the settlement is for the costs the Company incurred in making alternative plans to store the fuel, i.e. construct and maintain the dry cask storage facilities, as a result of the DOE's failure to take possession and dispose of the material. 2 TR 78. Therefore, the proceeds from the settlement with the DOE are not proper consideration in a PSCR plan case.

10. <u>The 2011 PSCR Plan Factor Should be Reduced by at Least $0.01/MWh to Account for the Company's Updated Planned Capacity Sales.</u>

In its PSCR plan the Company forecasted 708 MW of capacity sale during peak months in 2011, which will generate $13,853,856 in sales revenue. Exhibits A-7 & A-8. During the pendency of this case, the actual revenue from sales was, as of April 6, 2011, $13,921.440. The Mines seek to have the additional $67,584 included in the PSCR plan, which translates to a reduction in the factor of $0.01/MWh. The Company notes difference between its forecast and the actual sales goes to the proposition that this aspect of its PSCR is reasonable and prudent. However, the Company would not object if its Plan was updated to reflect its actual planned sales capacity. Accordingly, the PSCR factor should be adjusted to reflect the planned capacity sales amount as of April 6, 2011.

11. <u>Utilizing Proper Adjustments to the Company's Claimed 2009 PSCR Cost Under-Recovery, and Excluding the Company's Entire Claimed 2010 PSCR Cost Under-Recovery, Results in a 2009 and 2010 PSCR Reconciliation Cactor of $(1.03)/MWh.</u>

The Company's 2011 PSCR plan includes a 2009 PSCR reconciliation true-up amount of $496,010, and a 2010 PSCR under-recovery of $5,334,773. The Mines assert both amounts are inflated, and the proper amounts should be reflected in the 2011 PSCR plan factor. In support, it relies on Mr. Gorman's testimony in Case No. U-15644-R (2009 PSCR Reconciliation), and his testimony in this case concerning the 2010 PSCR Reconciliation. [11] 2 TR 201-203. Both the 2009 and 2010 Reconciliation cases are current pending, with the former awaiting the entry of the

[11] Subsequent to the filing of Mr. Gorman's testimony in this case, on March 31, 2011 the Company filed its 2010 PSCR Reconciliation application under Case No. U-16034-R.

Commission's Order, and the latter scheduled for hearing on November 17, 2011. In the 2009 PSCR Reconciliation case, the Company, Staff, and Mines are all advancing differing true-up amounts. The amount the Commission ultimately determines is warranted for 2009, is unknown at this point, and will be utilized in the Company's next PSCR Plan case. 2 TR 80. In Case No. U-16034, the Company seeks $6,193,903 as an under-recovery amount for 2010. In this case the Company estimated the amount at $5,334,773 based on established roll-in methodology for PSCR reconciliation. 2 TR 80. It would be improper to adjust the methodology in the manner suggested by Mr. Gorman in a PSCR Plan case.[12] Any such adjustment should be made in a reconciliation case, which is what Mr. Gorman is proposing in Case No. U-15644-R. Therefore, the Mines contention concerning the 2009 and 2010 under-recovery amounts in this proceeding is rejected.

12. <u>The Company Should Refund During the Remaining Months of 2011, the Entire Excess PSCR Revenue Collected from January 2011 until the Commission Enters a Final Order in this case. This Entire Over-Collection Should be Used to Further Reduce the 2011 PSCR Factor During the Remaining Months of 2011.</u>

In support of this contention, the Mines rely on the testimony of Mr. Gorman, who characterized the Company's self-implemented PSCR factor of $5.29 per MWh as inflated and unnecessary. 2 TR 204. This characterization is based on Mr. Gorman's ultimate conclusion that the Company's 2011 PSCR factor should be $ 2.85. Staff disagrees with this contention, noting Act 304 requires a prompt refund, with interest, of any amounts collected in excess of the Commission's final order. MCL 460.6j(9). A similar provision governs the reconciliation process. MCL 460.6j(14). Rather than

[12] The same is true for Dr. Loube's contention that the Company's 2010 PSCR Reconciliation should be adjusted to remove unreasonable and imprudent renewable energy costs. 2 TR 135-136. As discussed above, Dr. Loube's argument concerning the Company's cost for renewable energy is legally and factually deficient.

require an intra-period reconciliation, Staff seeks application of the statutory processes for refunds and collections. Assuming the relief sought by the Mines was available, Staff notes monthly fluctuations in PSCR costs could prejudice the Company's customers by requiring them to simultaneously pay a surcharge for the previous year PSCR factor and the current year factor. Adhering to the statutory processes for over-collection eliminates such prejudice. Finally, the purported over-collection from the Company's self-implemented PSCR factor is predicated on the reductions Mr. Gorman contends are warranted in this case. For the most part, those reductions, along with the corresponding PSCR factor Mr. Gorman advances, are rejected in this Proposal for Decision.

V.

CONCLUSION

Based on the foregoing, it is recommended that the Commission approve the Company's 2011 PSCR plan, with these amendments: remove any amount for the Point Beach Power Plant uprates; adjust the proposed Presque Isle Revenue Sufficiency Guarantee Make-Whole Payment; include the Edgewater 5 adjustment; adjust the cost of fuel oil hedges included in coal costs; remove the cost of renewable energy credits directly assigned to Wisconsin; reduce the PSCR factor to reflect the Commission's October 14, 2010 Order on Rehearing in Case No. U-15981 holding on lease pre-payment deferrals for ERGS Unit 2; and adjust the planned capacity sales amount to reflect actual sales as of April 6, 2011.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Dennis Mack

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Dennis W. Mack
Administrative Law Judge

ISSUED & SERVED: August 25, 2011
drr